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Jim Powell, Contributor

Rich Nations That Went Broke By Spending Too Much

Government spending drives taxes, deficits, debt and inflation, so it's at the core of our economic problems. What to do about runaway spending? The tendency is to imagine that it might be controlled by electing the right politicians, enacting a law like a balanced budget amendment, passing a spending limitation ballot initiative, establishing a super committee or coming up with some kind of "grand bargain."

These and other well-intended strategies have failed, primarily because they were attempts to have politicians act against their self-interest. Politicians generally want more power which means more money, more laws, regulations and bureaucrats. Historical experience suggests that rulers – whether kings, dictators or elected politicians — have a visceral urge to spend money they don't have. They can't control themselves. They'll weasel their way around any efforts to put a lid on the cookie jar. This is why rich nations like Japan, Saudi Arabia and the United States are spending money they don't have and incurring chronic budget deficits.

All of this has been has been going on for a very long time, a reminder that we're dealing with one of the most potent forces in politics. Runaway spending repeatedly has contributed to the downfall of the high and mighty.

For example, spending problems began to be evident in the early years of the Roman Empire, and they became huge in the third century C.E. Perhaps as early as the third century B.C.E., Rome began minting a gold coin that came to be known as the *aureus*. Originally the face value of the coin equaled the market value of gold in it.

Then gangster rulers spent money they didn't have on grain subsidies, public entertainments, a gigantic bureaucracy and military establishment. These rulers relentlessly raised taxes and debased money, crippling the economy. They tried to pay their bills by debasing the *aureus*. They issued gold coins that had the same face value but less and less gold. In 81 B.C.E. (when Sulla ruled), the aureus had 10.9 grams of gold, but this declined to 9.09 grams in 50 B.C.E. (Pompeius), 8.18 grams in 46 B.C.E.

when Caesar ruled, then 7.80 grams in 15 B.C.E. (Augustus), 7.27 grams in 60 C.E. (Nero), 6.55 grams in 214 C.E. (Caracella), 5.45 grams in 292 C.E. (Diocletian), 4.54 grams in 312 C.E. (Constantine) and 3.29 grams in 367 C.E. (Valentinian).

There was inflation: prices increased as merchants demanded more coins for their goods (a higher total face value), to assure that their payment in gold would be the same as before. Rome's silver coin, the *denarius*, was similarly debased. Monetary chaos, with so many coins circulating that weren't what they appeared to be, contributed to economic chaos, a major factor in the fall of the Roman Empire.

Chinese rulers introduced paper money sometime after 960 C.E. Evidently they soon discovered they could acquire their favorite luxuries and pay their armies by printing more money, and they did it with gusto. In the late 13th century C.E., the Venetian merchant and chronicler Marco Polo – with little knowledge of China's past experience — marveled at the brilliance of the Mongol ruler who "may truly be said to possess the secret of the alchemists." He persuaded merchants to give him wonderful things, and all he offered in return were stamped pieces of paper made from the bark of mulberry trees. It was a nice racket. Unfortunately, people realized that paper money lost value as prices took off, at which point everyone tried to avoid it. To keep the paper money game going, some rulers decreed the death penalty for malcontents who wouldn't accept it.

A dynasty's paper money was wiped out when, as eventually happened, the dynasty was defeated by invaders or rebels. The new rulers issued their own paper money that, like its predecessors, was depreciated and wiped out. Altogether, seven Chinese dynasties issued paper money. Occasionally new paper money was exchanged for old at rates up to 1,000 to 1 (old-to-new). Chinese records show that the money supply soared more than 3,200-fold between 1260 and 1330 C.E. During this period, inflation was a factor in the collapse of the Song and Yuan dynasties. Next came the Ming dynasty that introduced its own paper money, but reportedly it lost 99 percent of its value by 1425. Then the Ch'ing dynasty tried paper money, but it lost all its value in 11 years. The Ch'ing dynasty tried paper money again, but it became worthless in only 8 years. Runaway inflation was a factor in the collapse of Chiang Kai Shek's struggle against Mao Zedong's communists in 1949.

England, where industrial prosperity first began to develop, had a series of spendthrift sovereigns. The most reckless of these was probably Henry VIII (ruled1509-1547). This was the royal who married six times. He spent huge sums on his palaces, on his legions of government employees, on the British Navy and on wars against France. Biographer Derek Wilson noted that due to inconvenient tax resistance, "the King's needs and wants could not be simply furnished by going to the people [for more revenue]."

Henry VIII enjoyed windfall gains from confiscating Catholic Church properties in England, but he found himself in financial trouble again. He resorted to the old trick of issuing coins with less gold or silver content than was indicated on the face of the coins –

the “Great Debasement” as it was called. The king was broke. Ironically England’s first bankruptcy law was enacted during his reign, to protect creditors.

The English penny had 1,438 milligrams of silver in 1299 C.E., but this had dwindled to 687 milligrams in 1526, during the reign of Henry VIII. There were just 518 milligrams of silver in 1552 when his successor Edward VI ruled.

Spain was the only nation to extract significant quantities of gold and silver from the New World. During the 16th century, convoys of treasure ships seemed to give Spain a big advantage over its European rivals. But King Philip II (ruled 1554-1598) seems to have spent it all and then some on wars and luxuries like the gigantic El Escorial royal residence, monastery, library and art gallery (altogether with almost 15 miles of corridors). El Escorial was a 21-year “shovel ready” construction project to celebrate a costly Spanish war victory over the French. Philip ended up defaulting on his debts four times – in 1557, 1560, 1575 and 1596.

Royal revenues more than doubled during the four decades of Philip’s reign, but spending increased even faster. Altogether, there were deficits for 28 of 30 years. In 1576, when Philip’s revenue was up more than 50 percent, his debt jumped one-third. His last bankruptcy occurred during the decade that was the peak of gold and silver shipments to Spain. That’s when Philip was deepest in debt!

The great majority of central banks were established after 1900 to help governments spend money they didn’t have. They became engines of inflation. The largest number of runaway inflations and the worst runaway inflations have occurred since 1900.

Probably the most famous runaway inflation was in Germany, climaxing in 1923. It has been widely blamed on reparations demanded by Germany’s victorious adversaries in World War I, but reparations peaked at11.8 percent of the government’s budget during the runaway inflation.

How, then, to account for it? Before the war, Germany had established a big welfare state, and during the war it expanded dramatically. It wasn’t dismantled after the war. Germany had a financially troubled government-run pension system like our Social Security. The German government provided health insurance for millions of people. There were German government programs for 1.5 million disabled veterans. The German government bailed out municipalities. The government lavished subsidies on the arts. There were government-run theaters and opera houses. Government-owned railroads lost money. Government-run enterprises couldn’t even make money producing margarine and sausages.

This runaway inflation destroyed savings, bankrupted and disillusioned middle class Germans whom Adolf Hitler appealed to as “starving billionaires” – they had billions of paper marks but couldn’t afford a loaf of bread. Hitler emerged as a political figure to reckon with during that runaway inflation.

The current Greek financial crisis is primarily the result of runaway domestic spending. Budget deficits have gone up whether revenues went up or down – and the government took on more and more debt.

Greece has bloated government bureaucracies where unionized employees were accustomed to being paid for 14 months' work every 12 months. For decades, Greek politicians pacified disgruntled citizens by adding people to the government payroll, and now about 1 out of every 4 Greeks work for the government. In an unsuccessful effort to pay for all the spending, taxes were raised so high that more and more Greeks did business tax-free on the black market. An estimated one-third of the economy is "off-the-books." The Greek government put about 6,000 sun-kissed islands up for sale, looking for millionaires and billionaires who might want a very special place to call their own.

What does all this mean for the United States that recently achieved a dubious milestone — national debt equal to 100 percent of GDP? It's politically almost impossible to control runaway spending when people believe that government can continue making payments. As long as there's any money in the lock box, political pressure will be overwhelming to spend it. The tens of millions of voters who receive government benefits – such as elderly pensioners, unionized government employees, solar panel hustlers and rich Wall Street bankers - are likely to demonize courageous politicians who suggest the government can no longer afford to pay for everything. This is where we are now.

An opportunity for spending reform could come when people begin to recognize warning signs of a looming government bankruptcy, like late benefit payments, failed government bond auctions, crashing dollar exchange rates or accelerating inflation. When the financial crisis hits, it's likely to break the iron grip of pro-spending lobbyists and make serious reforms possible.

In such circumstances, political leaders are unlikely to choose brand new ideas. Rather, they'll consider ideas that already have been much discussed and debated, ideas that are familiar to people and viewed as responsible. The urgent task for many of us now is to help put free market ideas "in the air," so they might be adopted during a financial crisis. Political support would develop if more and more people conclude that these are the least bad options for them, since they would end up with something that's better than nothing.